

Where a social club, qualified for tax exemption under section 501(c)(7) of the Internal Revenue Code of 1954, finds it impracticable to continue to conduct its exempt activities and, as a result, sells its property and liquidates, such sale is incidental to its exempt purposes and the club is still to be considered as operated exclusively for pleasure, recreation and similar purposes up through the date of the sale and distribution of the liquidated assets to its active members.

Advice has been requested whether a tax exempt social club which is unable to continue its exempt activities will be deprived of its exemption because a profit was realized on the sale of all the club's property upon liquidation.

A club was incorporated, as a corporation without stock, under the laws of the state in which it was located, for the purpose of operating a golf club exclusively on a nonprofit basis for the pleasure and recreation of its members. The club membership was composed of two groups, the regular members, who held certificates of indebtedness in the Club's property and a small number of associate members, who were proposed by and approved of in the same manner as the regular members, but who were not to share in the distribution of the assets of the club.

As the years progressed, it became apparent that the club was in peril due to the urbanization of the immediate surrounding area.

Among the problems faced by the club were increased real estate assessments; rearrangement of its golf course made necessary by the city's street-building activities; and the imminent possibility of further condemnation of additional golf property for the widening of a boulevard which would render the club facilities useless for club purposes. Several offers were received from builders who desired to use the property for residential development and finally, on recommendation of the board of directors, prospective purchasers were invited to submit bids. After negotiations, an offer for purchase of the property was accepted and a contract of sale was executed. The price was payable in part upon execution of the contract, in part upon closing date, and the balance was secured by a purchase money mortgage at four and one-half percent interest payable in three years. After an agreed date there were no club activities except to collect interest on notes and to defend the club from claims of past members. A committee had been appointed, while the sale was still being negotiated, to find a new location for the club, but no adequate facilities were found and no serious action was taken in this respect. The personal property was also sold. Shortly after the sale of the property, the club passed a resolution to dissolve and commenced distribution of the proceeds to the certificate holders, who were entitled to the amounts. The mortgage was paid in full at maturity.

To qualify for exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954, a social

club must be organized and operated exclusively for pleasure, recreation and other nonprofit purposes and no part of its net earnings may inure to the benefit of any private shareholder. Section 1.501(c)(7)-1(b) of the Income Tax Regulations states that an incidental sale of property will not deprive the club of its exemption. It has also been held that sales of property at a profit will not cause a social club to lose its exemption provided the sale is incidental to the club's purpose. See *Santee Club v. White*, 87 Fed. (2d) 5; *Anderson Country Club v. Commissioner*, 2 T.C. 1238 acquiescence, C.B. 1944, 2; *Koon Kreck Club v. Thomas*, 108 Fed. (2d) 616.

In determining whether the transaction in the present case is an incidental sale or a sale primarily for profit, it is necessary to examine the circumstances under which the sale was made and determine the primary purpose of the sale. The extensive urbanization of the area surrounding the club, the increased taxes and expenses occasioned thereby, the probable condemnation of a large section of the land and continued trespasses all indicate that the further continuance of the club would not be possible. Therefore, the sale of the club property was for the purpose of facilitating its dissolution and not primarily for a profit. In G.C.M. 19465, C.B. 1938-1, 172, it is held that a social club does not lose its exemption by reason of the sale at a profit of its club properties to avoid financial burden. The sale of the property and the distribution of its assets are important transactions in the dissolution of a club and, as such, these activities do not form a basis on which to deprive the club of its exemption. This transaction was obviously a singular event in the club's history and to facilitate the dissolution does not convert a social club into a real estate business. The sale was incidental to the club's purpose.

The fact that a portion of the profit resulting from the sale was distributed to the members does not cause the club to lose its exemption. Every social and recreational group has a prospect of eventually being disbanded and dissolved. Therefore, the fact that the assets of a club will, upon dissolution, be paid to members or shareholders is not alone sufficient to make the organization liable to render income tax returns. See S.M. 2710, C.B. III-2, 230 (1924), and *Mill Lane Club Inc. v. Commissioner*, 23 T.C. 433, acquiescence C.B. 1955-1, 5.

Another aspect of this case is whether the holding of the mortgage note and the collection of interest were something more than a mere incident to the sale and liquidation, that is, whether it became a profit making venture for the club which would cause the club to lose its exemption. The receipt of interest on its purchase money mortgage did not deprive the taxpayer of its exempt status. The method of settlement on this sale of land was as practical and reasonable a method of payment as could be expected and it resulted in the fastest possible liquidation without depriving the taxpayer of a just price by the

necessity of demanding full payment in cash. As long as no repeated extensions of the mortgage note were granted and there being no other evidence to show an investment purpose, the settlement under the facts herein stated is considered an ordinary and reasonable method of settlement and an integral part of the sale. As such, it does not affect the taxpayer's exempt status.

As to the possibility of considering this as a sale for profit rather than a sale for liquidation because of the fact that an effort was made to locate a new site, the taxpayer would not lose its tax status because the conversion of property to other property better suited to serve the operations of a club is a valid purpose within the contemplation of the Code. I.T. 3302, C.B. 1939-2, 105.

Accordingly, it is held that where a social club, qualified for tax exemption under section 501(c)(7) of the Code, finds it impracticable to continue to conduct its exempt activities and, as a result, sells its property and liquidates, such sale is incidental to its exempt purposes. The club is still to be considered as operated exclusively for pleasure, recreation, and similar purposes up through the date of the sale and distribution of the liquidated assets to its active members. The profit from the sale by the club of all its property in conjunction with the termination of its activities and liquidation does not deprive the club of the exemption provided by section 501(c)(7) of the Code.